State 401(k) idea: the downsides; GOVERNOR'S PROPOSAL IS RISKY AND NEEDS FURTHER SCRUTINY

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State and local governments in California have a problem on their hands: They've promised their workers pensions that are more generous than they can afford. That leaves government agencies borrowing money and taxpayers footing the bill for underfunded pensions across the state. Gov. Arnold Schwarzenegger wants to get rid of the problem by getting rid of pensions altogether. He plans to replace them with 401(k)-style plans, which have become common in the private sector.

There are reasons to believe that Schwarzenegger's solution may be a bit like prescribing shock therapy for a patient with a migraine. The appeal of the 401(k)-type program for governments is easy to grasp. Under such programs, the employer pays each worker up front a fixed sum every quarter and that's the end of it. Whatever the worker does with the money, it's not the employer's problem.

In contrast, pensions are long-term promises, payments that will be made to retirees as long as they live. If a government agency miscalculates how much it needs to put aside to make those payments, as employers often do, it has to pitch in more to keep the promises. Ditto if the stock market does poorly, as it did in recent years. Ditto if retirees live longer, as they increasingly tend to do.

But the governor's plan, which is modeled on a constitutional amendment

introduced by Keith Richman, a Republican Assembly member from Granada Hills, has some serious potential downsides for both governments and workers:
First, any savings won't be achieved for years. Under Richman's plan, only government workers hired after mid-2007 will be covered by the 401(k) plans. Existing employees will remain under CalPERS and other pension plans. That means current plans will be a fact of budget life for as long as three decades or more. And many critics have pointed out it will cost even more to manage two sets of plans during the transition period.

Second, for many workers, the 401(k) program could represent a radical cut in benefits. Conscientious workers who begin saving early -- in their 20s -- and put enough money aside may do well under a 401(k) plan. But experience from the private sector shows most workers aren't that prudent, lack money-management skills and end up with inadequate nest eggs. If that's the case, retirees would end up relying on government services, including Medicaid, and any savings achieved by the state could quickly vanish.

Third, pensions have been a tool to lure workers to the public sector. Do away with them, and government agencies will have a harder time recruiting nurses, teachers, tech workers, scientists and other professionals.
As proposed, Schwarzenegger's idea is not well thought out and deserves far more debate and scrutiny. Then again, it may simply be a radical idea aimed at getting the other side -- the Democrats -- to react and acknowledge the obvious:
State pensions, and particularly some overly generous promises made to workers, are in need of thoughtful reform.

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